

Report of the auditor-general to the Eastern Cape Provincial Legislature and the council of the Inxuba Yethemba Local Municipality

Report on the financial statements

Introduction

1. I was engaged to audit the financial statements of the Inxuba Yethemba Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2016, the statement of financial performance, statement of changes in net assets and cash flow statement and statement of comparison of budget information with actual information for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the South African Standards of Generally Recognised Accounting Practise (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act, 2003 (Act No.56 of 2003) (MFMA) and the Division of Revenue , 2015 (Act No.1 of 2015) (DORA) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-general's responsibility

3. My responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the International Standards on Auditing. Because of the matters described in the basis for disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

Property, plant and equipment

4. I was unable to obtain sufficient appropriate audit evidence that property, plant and equipment had been properly accounted as the municipality did not have adequate asset management systems in place for the recording of all transactions and events. I could not confirm property, plant and equipment by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to property, plant and equipment stated at R571,5 million (2015: R585,4 million) as disclosed in the statement of financial position and note 10 to the financial statements.

5. The municipality did not have an adequate process to ensure that all items of property plant and equipment as disclosed in statements of financial position and note 10 to the financial statement were recorded and valued in the current and prior year correctly as required by GRAP 17, *Property, Plant and Equipment*. As a result, the property, plant and equipment in statement of financial position and note 10 to the financial statements was overstated by R52,7 million (2015: R52,7 million). Additionally, there was a resultant impact on the accumulated surplus.

Investment property

6. I was unable to obtain sufficient appropriate audit evidence that investment property had been properly accounted as the municipality did not have adequate systems in place for the recording of all transactions and events. I could not confirm investment property by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to investment property of R45,4 million (2015: R44,9 million), as disclosed in the statement of financial position and note 8 to the financial statements.
7. The municipality did not have an adequate process to ensure that all items of investment property as disclosed in statement of financial position and note 8 to the financial statement were recorded, valued and classified correctly in the current year and prior year as required by GRAP 16, *Investment Property*. As a result investment property in statement of financial position and note 8 to the financial statement was overstated by R24,8 million in the current year and understated by R19,6 million in the prior year. Additionally, there was a resultant impact on the accumulated surplus.

Heritage assets

8. I was unable to obtain sufficient appropriate audit evidence that heritage assets had been properly accounted as the municipality did not have adequate systems in place for the recording of all transactions and events. I could not confirm heritage assets by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to heritage assets stated at R5,4 million (2015: R5,4 million), as disclosed in the statement of financial position and note 9 to the financial statements.

Commitments

9. I was unable to obtain sufficient appropriate audit evidence that commitments had been properly accounted as the municipality did not have adequate systems in place for the recording of all transactions and events. I could not confirm commitments by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to commitments stated at R33,8 million (2015: R26,4 million), as disclosed in note 35 to the financial statements.

Irregular expenditure

10. I was unable to obtain sufficient appropriate audit evidence that irregular expenditure had been properly accounted as the municipality did not have adequate systems in place for the recording of all transactions and events. I could not confirm irregular expenditure

by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to irregular expenditure stated at R67,6 million (2015: R45,6 million), as disclosed in note 39 to the financial statements..

11. The municipality made payments in contravention of supply chain management (SCM) regulations. These payments were not disclosed in note 39 to the financial statements. In addition, disclosed amounts did not agree with the actual expenditure. Consequently, the irregular expenditure has been understated by R23,9 million (2015: R235,3 million).

Unauthorised expenditure

12. I was unable to obtain sufficient appropriate evidence that the municipality incurred the unauthorised expenditure as the municipality did not have adequate systems in place for the recording of all transactions and events as disclosed in note 37 of the financial statements. I could not confirm unauthorised expenditure by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to unauthorised expenditure stated at R22,9 million as disclosed in note 37 to the financial statements.

Prior period error

13. I was unable to obtain sufficient appropriate audit evidence for the prior period errors as disclosed in note 46 to financial statements as the supporting information was not provided. I was unable to confirm these disclosures by alternative means. Consequently, I was unable to determine whether any adjustments were necessary relating to the prior period errors disclosed in the financial statements.

Disclaimer of opinion

14. Because of the significance of the matters described in the basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matters

15. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Restatement of corresponding figures

16. As disclosed in note 46 to the financial statements, the corresponding figures for 2014-15 have been restated as a result of errors discovered during 2015-16 in the financial statements of the municipality at, and for the year ended, 30 June 2015.

Material impairments and losses

17. As disclosed in notes 4, 5 and 6 to the financial statements, material losses of R 120,4 million (2015: R99,8 million) were incurred as a result of impaired irrecoverable receivables from exchange and non-exchange transactions.

18. As disclosed in note 44 to the financial statements, electricity losses of R11,7 million (2015: R9,7million) were incurred during the financial year.

Fruitless and wasteful Expenditure

19. As disclosed in note 38 to the financial statements, fruitless and wasteful expenditure of R2,0 million (2015: R1,7 million) was incurred during the financial year due to the municipality not adhering to MFMA requirements on payment of creditors.

Financial viability

20. The financial statements indicated that the Inxuba Yethemba Local Municipality incurred a net deficit of R41,5 million during the year ended 30 June 2016 and, as of that date, the municipality's current liabilities exceeded its current assets by R70,8 million. These conditions indicated a material uncertainty that may cast significant doubt on the municipality's ability to continue providing uninterrupted services to its community..

Additional matters

21. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Withdrawal from the audit engagement

22. Due to the limitation imposed on the scope of the audit by management, I have disclaimed my opinion on the financial statements. But for the legislated requirement to perform the audit of municipality, I would have withdrawn from the engagement in terms of the ISAs.

Unaudited disclosure notes

23. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with this legislation. This disclosure requirement did not form part of the audit of the financial statement and, accordingly, I do not express an opinion on it.

Unaudited supplementary information

24. The supplementary information set out on pages XX to XX does not form part of the financial statements and is presented as additional information. I have not audited this schedule and, accordingly, I do not express an opinion on it.

Report on other legal and regulatory requirements

25. In accordance with the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives of selected development priorities presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading but not to gather evidence to express

assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

Predetermined objectives

26. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development priorities presented in the annual performance report of the municipality for the year ended 30 June 2016:
- Development priority 5: Community Service on pages x to x
 - Development priority 6: Technical Services on pages x to x
27. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned development priorities. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's Framework for Managing Programme Performance Information (FMPPI).
28. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
29. The material findings in respect of the selected development priorities are as follows:

Community services

Usefulness of reported performance information

30. Section 54(1)(c) of the MFMA determines that the service delivery and budget implementation plan adopted by the municipal council may be amended only if the council approves an adjustments budget. Changes to the service delivery and budget implementation plan in the year have to be made in accordance with the process as prescribed per section 28 of the MFMA. Material changes were made to important indicators and targets in the annual performance report, without following the process as prescribed in section 28 of the MFMA and without adoption by the municipal council.
31. The measurability of 75% of planned targets and indicators could not be assessed due to a lack of technical indicator description and proper systems and processes coupled with formal standard operating procedures or documented system descriptions. This was because, while management was aware of the requirements of the FMPPI, it did not have the appropriate systems and processes implemented and did not exercise due care to enable the application of the principles.

Reliability of reported performance information

32. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. We were unable to obtain the information and explanations we considered necessary to satisfy ourselves as to the reliability of the reported performance information. The scope of our work was limited by the auditee not being able to provide sufficient appropriate evidence in support of the reported performance information.

Technical services

Usefulness of reported performance information

33. Section 41(c) of the Municipal Systems Act (MSA) requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 29% of the reported indicators were not consistent with those in the approved integrated development plan. This was because the annual performance report was not properly reviewed to ensure that planned targets were according to the approved 2015-16 service delivery and budget implementation plan.
34. Section 54(1)(c) of the MFMA determines that the service delivery and budget implementation plan adopted by the municipal council may be amended only if the council approves an adjustments budget. Changes to the service delivery and budget implementation plan in the year have to be made in accordance with the process as prescribed in section 28 of the MFMA. Material changes were made to important indicators and targets in the annual performance report, without following the process as prescribed in section 28 of the MFMA and without adoption by the municipal council.
35. The processes and systems that produced the indicator should be verifiable, as required by the FMPPI. A total of 24% of the indicators in relation to service delivery were not verifiable. This was because, while management was aware of the requirements of the FMPPI, it did not have the appropriate systems and processes implemented and did not exercise due care to enable application of the principles.

Reliability of reported performance information

36. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. We were unable to obtain the information and explanations we considered necessary to satisfy ourselves as to the reliability of the reported performance information. The scope of our work was limited by the auditee not being able to provide sufficient appropriate evidence in support of the reported performance information.

Additional matters

37. I draw attention to the following matters:

Achievement of planned targets

38. Refer to the annual performance report on pages x to x for information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information in paragraphs x to x of this report.

Unaudited supplementary information

39. The supplementary information set out on pages x to x does not form part of the annual performance report and is presented as additional information. I have not audited these schedules and, accordingly, I do not express a conclusion on them.

Compliance with legislation

40. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

Strategic planning and performance management

41. The local community was not afforded the opportunity to comment on the final draft of the integrated development plan (IDP) before adoption as required by section 42 of the MSA and Municipal planning and performance management regulation 9, 13(1), 13(4)(c) and 15(3).

42. The amendments to the integrated development plan did not adhere to the requirement of municipal planning and performance management regulation 3(4) of being adopted by the council only after:

- all the members of council have been given reasonable notice
- the proposed amendment has been published for public comment
- consultation with the district and taking into account all comments received.

43. The municipality did not establish a performance management system as required by section 38(a) of the MSA and the Municipal planning and performance management regulation 8.

44. An effective performance management system and related controls were not in place. They did not describe and represent the processes of performance planning, monitoring, measurement, review, reporting and improvement, and how it is conducted, organised and managed. This would include determining the roles of the different role-players. These are the requirements of sections 38 of the MSA and municipal planning and performance management regulation 7.

45. The performance management system did not fulfil the requirement of section 38(a) of the MSA and municipal planning and performance management regulation 7(2)(c, e, f, g), as it:
- was not in line with the priorities, objectives, indicators and targets contained in its integrated development plan
 - did not clarify the roles and responsibilities of each role-player
 - did not determine the frequency of reporting and the lines of accountability
 - did not relate to the employee's performance management processes
 - did not link to the integrated development planning processes.
46. The performance management system did not provide for monitoring, measuring and reviewing performance at least once per year, as required by section 41 of the MSA.
47. The performance management system did not provide policies and procedures for corrective measures of improvement where performance targets were not met, as required by section 41 (1)(d) of the MSA.
48. Performance targets were not set for each of the key performance indicators for the financial year, as required by section 41(1)(b) of the MSA and municipal planning and performance management regulation 12(1) and 12(2)(e).
49. Revisions to the service delivery and budget implementation plan were not approved by the council, as required by section 54(1)(c) of the MFMA.

Annual report and annual financial statement

50. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements identified by the auditors in the submitted financial statements were not adequately corrected and the supporting records could not be provided subsequently, which resulted in the financial statements receiving a disclaimer of audit opinion.
51. The consolidated financial statements were not submitted for auditing, within three months after the end of the financial year, as required by section 126(1)(b) of the MFMA.
52. Late submission of the annual financial statements to the Auditor-General for auditing was not appropriately addressed by the mayor and municipal council, as required by section 133(1) of the MFMA.
53. The 2014-15 annual report was not published for the local community to submit representations in connection with the annual report, as required by section 127(5)(a) of the MFMA.
54. The oversight report adopted by the council on the 2014-15 annual report was not made public, as required by section 129(3) of the MFMA.

Procurement and contract management

55. Goods and services with a transaction value below R200 000 were procured without obtaining the required price quotations in contravention of by SCM regulation 17(a) and (c).

56. Invitations for competitive bidding were not always advertised for a required minimum period of days, in contravention of SCM regulation 22(1) and 22(2).
57. Thresholds for local content on designated sectors' procurement were not properly applied in accordance with the requirements of preferential procurement regulation 9.
58. Contracts were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state as required by SCM regulation 13(c).
59. Contracts were extended without tabling the reasons for the proposed amendment in the council of the municipality, as required by section 116(3) of the MFMA.
60. Contracts were extended or modified without the approval of a properly delegated official, in contravention of SCM regulation 5.
61. The performance of contractors or providers was not monitored monthly, as required by section 116(2)(b) of the MFMA
62. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, in contravention of section 116(2)(c) of the MFMA
63. Awards were made to providers who were in the service of the municipality and whose directors or principal shareholders were in the service of the municipality, in contravention of section 112(j) of the MFMA and SCM regulation 44. Furthermore the provider failed to declare that they were in the service of the municipality, as required by SCM regulation 13(c).

Human resource management

64. Senior managers directly accountable to the municipal manager were appointed without the approval of the municipal council, in contravention of section 56(1)(a) of MSA.
65. The competencies of financial and SCM officials were not assessed in a timely manner to identify and address gaps in competency levels, as required by Municipal Regulations on Minimum Competency Levels 13.

Expenditure management

66. Reasonable steps were not taken to prevent unauthorised, irregular as well as fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Asset management

67. An adequate management, accounting and information system that accounts for assets was not in place, as required by section 63(2)(a) of the MFMA.
68. An effective system of internal control for assets (including asset register) was not in

place, as required by section 63(2)(c) of the MFMA.

Consequence management

- 69. Sufficient appropriate audit evidence could not be obtained that authorisation of unauthorised expenditure was done through an adjustment budget, as required by section 32(2)(a)(i) of the MFMA.
- 70. Unauthorised, irregular as well as fruitless and wasteful expenditure by the municipality was not investigated to determine if any person was liable for the expenditure, as required by section 32(2)(a)/b of the MFMA.

Internal control

- 71. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for disclaimer of opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.

Leadership

- 72. Leadership did not oversee the implementation and monitoring of internal controls, which led to material misstatements of the financial statements and reported performance information as well as non-compliance with legislation. In addition, leadership did not implement effective human resource management to ensure that adequate and sufficiently skilled resources were in place.
- 73. The municipality's audit action plan was finalised late, which affected its effective implementation and monitoring it. As a result, numerous internal control deficiencies identified in the previous year recurred in the current year.

Financial and performance management

- 74. Inadequate record management and daily, weekly and monthly financial disciplines continued to have an impact on the financial administration of the municipality. Reconciliations and registers were only prepared after the financial year end, which did not allow sufficient time for adequate reviews. This resulted in errors being detected during the audit process.
- 75. The financial statements submitted for audit contained material errors, as the financial statements and supporting documents were not adequately reviewed prior to their submission.
- 76. The systems for preparing and reporting performance against predetermined objectives were not adequate as we identified material errors on the usefulness and reliability of performance information.

Governance

- 77. Governance structures did not appropriate action to ensure that adequate risk management is implemented and monitored.
- 78. Management failed to implement the recommendations of the audit committee, which resulted in external audit findings.
- 79. The municipality has an audit committee and internal audit; however, both these governance structures' ability to provide assurance was limited due to delays imposed by management.

Auditor-General

East London

30 November 2016



AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence